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August 17, 2012

TO: The Honorable Mike Bell, Chair
Senate Committee on Government Operations

The Honorable Jim Cobb, Chair
House Committee on Government Operations

FROM: Arthur A. Hayes, Jr., CPA
Director of the Division of State Audit

SUBJECT: Follow-up on the October 2009 Alcoholic Beverage Commission performance audit

This follow-up of the 2009 performance audit of the Alcoholic Beverage Commission was conducted pursuant to the Tennessee Governmental Entity Review Law, *Tennessee Code Annotated*, Title 4, Chapter 29. Under Section 4-29-234, the Alcoholic Beverage Commission is scheduled to terminate on June 30, 2013. This follow-up report is intended to aid the Joint Government Operations Committee in determining whether the commission should be continued, restructured, or terminated.

We found the commission has taken sufficient action to resolve the findings identified in the October 2009 performance audit although we do make recommendations for improvement in the areas of cash management, fine payment, and server permit background checks.


Follow-up Information

2009 Performance Audit Finding 1:

In spite of three past cases of employee theft of cash, management of the Alcoholic Beverage Commission still has not established adequate segregation of duties in the receipting, depositing, and reconciling of cash at the Nashville office to effectively safeguard against additional fraud in the future

Although the commission had made improvements in the Nashville office, changes in the office had not resolved the deficiency in the adequate segregation of duties. One individual collected cash and checks, prepared the deposit, maintained a deposit log, and entered the deposit data into the state accounting system.

State Audit's 2012 Follow-up Review Results

We interviewed senior and support staff to determine what steps the commission has taken to address the prior performance audit finding pertaining to its cash management practices. Auditors also reviewed commission policies to determine whether the commission has established policies for segregating its cash management operations.  **B.4.1**

Auditors also visited each of the commission's regional offices (Knoxville, Chattanooga, and Memphis) to determine whether the commission's cash management policies were being implemented consistently in each location. As part of our field visits, we interviewed staff and observed them perform their jobs. At each location, we took a random sample of daily bank deposits submitted in 2011 and compared these amounts with the amount recorded in the commission's daily logs used to record customer fee payments.

Our findings were mixed. Although there were some improvements in policies and procedures and hiring staff to facilitate better controls, tests of transactions at two offices revealed breakdowns in the way transactions were controlled.

We found the following:

- The commission has established formal written policies that appear to provide for adequate segregation of its cash management operations.
- The commission created and filled cashier positions in the central office in Nashville as well as at each of the three regional offices which also receive permit/license fees and payments for fines and citations.
- Auditors noted that the commission's central office and the three regional offices have apparently segregated the daily functions of receiving, recording, verifying, and depositing funds.

Despite these positive steps taken by the commission, we found mixed results in our comparison of daily deposits with the daily logs. Namely, in the central office we noted that on one occasion the amount of the daily bank deposit exceeded the amount recorded in that day's logs. In the Knoxville office, we found no issues with the daily bank deposits and their respective logs. In the Chattanooga office, we found that the daily bank deposit exceeded the amount recorded in the respective day's logs on 20% of the dates that we reviewed. Similarly, in the Memphis office we noted that the daily bank deposit exceeded the amount recorded in the respective day's logs on 60% of the dates that we reviewed.

Whenever staff fail to record all transactions, the risk of fraud, waste, or abuse is increased. Staff will make occasional mistakes. It is management's responsibility to take steps to create a control environment in which errors are promptly identified and corrected.

Furthermore, it is essential that staff see there are consequences for not following policies and procedures. No matter how well a system of internal controls is designed, if staff feel that noncompliance is without consequences, the controls are ineffective.

Commission officials stated that the failure of staff to consistently record all transactions on the daily logs was the cause of this issue. It is important to note that although logs and bank deposits did not match, a thorough review of all documentation for the sample, including bank statements, check numbers, and deposit slips, found that the proper amount of receipts was deposited by commission staff. The primary issue is the commission's failure to accurately record fee payments.

As to be expected, there was a high correlation between the frequency and thoroughness of oversight reviews of the recording, receipt, and deposit of funds and the respective error rates at the various offices. The frequency of reviews ranged from one extreme such as in Knoxville, where reviews are conducted on a daily basis, to the other extreme such as in Memphis, where limited reviews are conducted only once a month.

As a result of our analysis, commission officials stated that they developed a formal written policy requiring staff to conduct daily checks of logs and bank deposits.

Recommendation

The commission should consider formalizing the frequency staff are to compare daily bank deposits against information recorded on daily logs.

2009 Performance Audit Finding 2:

Management of the Tennessee Alcoholic Beverage Commission has failed to adequately document its review of the commission's written policies and procedures manual and update those policies and procedures with needed changes in a timely manner

We found that 104 of the commission's 145 policies and procedures (72%) had not been documented as reviewed since May 1993.

State Audit's 2012 Follow-up Review Results

We reviewed all of the commission's policies and procedures to determine when they had been last reviewed and updated. We found that all but two policies had been reviewed since 2009. Commission officials state that the two identified policies had in fact been reviewed since 2009 and that the commission had incorrectly dated them. Based on our review, it appears that the commission has satisfactorily resolved this finding.

2009 Performance Audit Finding 3:

Management of the Tennessee Alcoholic Beverage Commission has failed to effectively or efficiently pursue unpaid fines from citations in a timely manner

Although the commission sends a notice to the violator at the time of license renewal indicating any fines owed, the violator is not required to pay outstanding fines before being allowed to renew a license.

State Audit's 2012 Follow-up Review Results

Our review found that although the commission continues to have difficulty collecting all assessed fines, it has taken steps to address this issue. Specifically, to more effectively collect fine payment, the commission hired an Assistant Director in October 2011 with one of his primary responsibilities being to pursue unpaid fines. Further, in 2011 and 2012 the commission unsuccessfully sought statutory change to allow it to withhold license renewals until outstanding fines are paid. Consequently, the commission has little authority to effectively enforce the payment of fines.

Recommendation

The General Assembly may wish to consider amending the license renewal statute to allow the commission to withhold licenses and renewals of licenses until all debts due to the state, whether taxes, fees, fines, or penalties, are paid.

2009 Performance Audit Finding 4:

The Tennessee Alcoholic Beverage Commission has operated the sever permit program at a deficit for two years without assessing fees sufficient to cover costs of operating the program

In two of the four years that we reviewed, program expenses exceeded revenue collected. Despite knowing that revenue does not cover expenses of the program, the commission has not yet met the statutory requirements to assess sever permit fees to cover the deficiency.

State Audit's 2012 Follow-up Review Results

We reviewed information from the commission demonstrating that effective June 8, 2010, fees for the server permit program increased from \$5 to \$20. We also reviewed fiscal year 2011 revenue and expense information for the server permit program. Our review found that for 2011, the program had a surplus of \$604,699. According to commission management, excess funds from the server permit program will be used to acquire new software to help better manage the program. The commission has satisfactorily resolved this finding.

2009 Performance Audit Finding 5:

The Tennessee Alcoholic Beverage Commission does not perform background checks to ensure those with criminal backgrounds do not obtain licenses to serve liquor

Statutes prohibit persons who have violated certain criminal codes from obtaining licenses or permits, and allow the commission to conduct criminal record review of applicants. However, the commission does not perform any criminal background checks but relies on applicants to self-report.

State Audit's 2012 Follow-up Review Results

In 2010 and 2012, legislation to expand background checks to include a nationwide search instead of only Tennessee convictions was introduced but did not pass. Therefore, although the commission is requiring every 100th applicant for a server permit to submit to a background check, these checks are limited to Tennessee. The Chief Law Enforcement Officer reviews results of the background check. However, the commission does not have the authority to deny a license or permit based on a background check. If a background check reveals a conviction, the applicant is asked to resubmit the application. The commission can then turn down the application based on the conviction. It appears that the commission has satisfactorily resolved this finding.

Recommendation

The General Assembly may wish to consider amending *Tennessee Code Annotated* to expand the commission's authority to conduct nationwide background checks for individuals applying for server permits. The General Assembly also may wish to consider amending state law to grant the commission the authority to deny a license or permit based upon the results of a background check.

2009 Audit Performance Finding 6:

The Confidential Informant Fund (Petty Cash) was allowed to exceed the \$1,500 maximum on multiple occasions

We reviewed the confidential funds accounts for the period from January to November 2008 and found the balance in the account exceeded \$1,500 for 10 of 11 months reviewed.

State Audit's 2012 Follow-up Review Results

We reviewed 12 monthly bank statements for calendar year 2011 and found none exceeded the maximum amount authorized of \$1,500. We reviewed documents demonstrating communication between the commission and the Department of Finance and Administration

(F&A) regarding an increase in the Confidential Informant Fund. However, while the commission sought to have F&A increase this fund, F&A has not increased the authorized amount.

Due to the lack of funding, according to Alcoholic Beverage Commission officials, the commission has had to partner with other police agencies to obtain sufficient funding to conduct operations. Commission agents have documented the funds used by other police agencies; however, monies used by other agencies are not tracked or recorded to demonstrate the funding that the commission would require to independently conduct its statutory function of enforcing state laws as they pertain to the purchase and consumption of alcohol. Until funds are increased, the commission will continue to rely on other police agencies for resources. As of March 2012, no changes have been made to the Confidential Informant Fund with respect to any increases or decreases.

While the commission appears to have addressed the previous performance audit's finding, it may wish to take additional steps to demonstrate its need to increase the threshold of the Confidential Informant Fund. For example, the commission should track the amount of funding provided by other police agencies to better demonstrate to F&A the true need of the commission.

2009 Performance Audit Finding 7:

The Tennessee Alcoholic Beverage Commission has not established an audit committee, nor has the commission requested an exception as required by state law since 2003

The "State of Tennessee Audit Committee Act of 2005" requires state entities to establish audit committees and allows the Comptroller of the Treasury to set guidelines and approve exceptions. In November 2005, the Comptroller sent a reminder to entities subject to the act to either establish an audit committee or seek an exception. The commission has not taken either action.

State Audit's 2012 Follow-up Review Results

The three members of the Alcoholic Beverage Commission now serve as the audit committee. We reviewed the Audit Committee minutes and the Audit Committee charter to ensure compliance with previous audit report finding. The audit committee has met three times since 2010. Items discussed include audit findings from the previous performance audit, internal audits conducted, employee disciplinary actions, background checks on applicants and an auditor position update. The commission has satisfactorily resolved this finding.

cc: Danielle Elks, Executive Director, Alcoholic Beverage Commission
Mary McDaniel, Chair, Alcoholic Beverage Commission